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DE RUEHIL #3388/01 3011246
ZNR UUUUU ZZH
R 271246Z OCT 08
FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 9493
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHML/AMEMBASSY MANILA 3051
RUEHBUL/AMEMBASSY KABUL 9304
RUEHNE/AMEMBASSY NEW DELHI 3940
RUEHLO/AMEMBASSY LONDON 8955
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RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
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RUEAIIA/CIA WASHDC
RUEKJCS/SECDEF WASHINGTON DC

UNCLAS SECTION 01 OF 02 ISLAMABAD 003388

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PREL](#) [PGOV](#) [PK](#)

SUBJECT: TAREEN ANNOUNCES HIS ECONOMIC PLAN AND KSE RETAINS FLOOR

1. (SBU) Summary. Pakistan's Advisor on Finance Shaukat Tareen discussed his nine point economic plan with the business community on October 25th, which according to him will bring the economy back on track. He asserted that he will raise the tax-revenue to GDP ratio to 15 percent from the current 10 percent by bringing untaxed and under-taxed sectors like agriculture and real estate into the tax net. Tareen said that the present government will focus on production-led growth instead of consumption-led growth. Yet so far, the economic indicators are defying the GOP efforts as the large scale manufacturing sector production dropped close to 5 percent in the first two months of the current fiscal year. The Karachi Stock Exchange (KSE) floor continues to be in operation and the KSE Board has not given any time line for lifting it. Despite previous efforts the GOP has failed to tax the agricultural sector, which according to some does not have huge revenue yielding potential since 90 percent of farmers are either subsistence farmers or landless tenants. The GOP also did not tax capital gains in the 2008-09 budget, which would have discouraged speculative trading in the stock exchanges. End Summary.

ECONOMIC ROADMAP

2. (SBU) In a nationally televised event, Advisor to the Prime Minister on Finance, Shaukat Tareen, addressed the traders and businessmen at the Federation of Pakistan Chambers of Commerce and Industry on October 25 and said that the government has drawn up a roadmap to revitalize the economy, which will have far-reaching effects in putting the economy back on track. Tareen's roadmap has nine elements, which include stabilizing macro economic indicators (i.e. inflation, budget deficit and exchange rate), introducing social safety nets such as Benazir Income Support Program, promoting agricultural development, encouraging manufacturing sector competitiveness, developing human resources, launching an integrated energy development plan, promoting public private partnerships, working on capital market and civil services reforms.

3. (SBU) The GOP says it needs USD 3 to USD 5 billion in the next 30 days to avert a possible default on its foreign debt obligations. Tareen said if the GOP decides to borrow money from the IMF, it will be based on its home grown economic package. He said that the fiscal deficit will be reduced to 4.3 percent from 7.4 percent and the tight monetary policy will be continued to check inflation. According to Tareen, the thrust of economic policies will now be shifted to production-led growth from a consumption-driven strategy and agriculture will be given top priority. Tareen said the country is faced with many challenges such as poverty and soaring inflation

and stated that the number of people earning one dollar per day has increased from 25 percent to 44 percent of the total population. (Comment: Dr. Ashfaque Hasan Khan, Economic Adviser at the Ministry of Finance, said that there are no surveys or statistics to substantiate poverty figures and termed it as a political statement. End Comment.)

DECLINING PRODUCTION

14. (SBU) Tareen also announced that Pakistan's industrial output declined by around 4.87 percent in the first two months of the current fiscal year, indicating that the 6.1 percent growth target set for 2008-09 is unlikely to be achieved. Many sub-sectors of the large-scale manufacturing sector did not perform well during July-August including electrical goods and textiles. The textile sector is labor intensive and any drop in textile production or exports can result in massive layoffs. The severe power shortage and highest-ever increase in energy prices also fueled the decline. The slump in industrial growth has affected the export of commodities, particularly the textile and clothing exports which declined by 0.77 percent in the first quarter of the current fiscal year.

INCREASING GOVERNMENT REVENUE

15. (SBU) Tareen said that the GOP will bring untaxed and under-taxed

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sectors into the tax system while the tax-to-GDP ratio will be increased from present 10.5 percent to 15 percent. Noting that there will be no sacred cows, Tareen claimed that real estate and agriculture will be taxed. Pakistan has a history of taxing agriculture through the land revenue system. Yet its collection has always remained negligible and far below its potential. The Federal Board of Revenue (FBR) struggled in early 2007 to convince the previous government to either permit federal taxation of farm income or let the Board collect it on behalf of the provinces.

16. (SBU) The FBR thought the agricultural income tax had the potential to generate estimated revenue of over Rs.60 billion (USD 737 million) a year. That amount could be gradually increased as the agriculture sector is about 21 percent of the nation's GDP. But the strong agriculture lobby, which has always formed a big part of almost all governments, was blamed for thwarting the FBR plans to effectively tax their income.

17. (SBU) A progressive farmer from Bahawalpur and a former head of the Small and Medium Enterprise Development Authority (SMEDA), Iqbal Mustafa, said that more than 90 percent of farmers are either landless tenants or small land owners. Mustafa stated "When we talk of agriculture income tax we're actually talking of taxing the bigger land holders whose number shouldn't be more than 4,000 to 5,000 in the country, which means that the agricultural tax will not raise revenue collection significantly." Implementation of the new taxes may also slow growth in the sector.

KARACHI STOCK EXCHANGE RETAINS FLOOR

18. (SBU) After a meeting with Shaukat Tareen and Chairman of Securities and Exchange Commission of Pakistan Razi-ur-Rehman on October 26th, the Board of Directors of Karachi Stock Exchange (KSE) decided that the floor set on share price will remain in place until the government funds for assistance and put option mechanics are finalized. The Board did not give any date for removal of the floor. In the meeting, the market stabilization measures were reviewed and it was noted that many measures, including increasing liquidity in the financial system and additional risk management measures, are in place. However, the mechanics of the put option fund and the National Investment Trust-State Enterprise Fund still required additional time for implementation. Noting that the

government has a right to protect its companies, Managing Director of the KSE, Adnan Afridi, defended the government decision to invest its funds in state owned companies since the fund is being provided by the government institutions. The Fund will invest in the following nine stocks: Oil and Gas Development Company Ltd, Kot Addu Power Company, Pakistan Petroleum Ltd, Sui Southern Gas Company, Sui Northern Gas Pipeline, Pakistan State Oil, National Bank, Pakistan Telecommunication Company Ltd and Habib Bank. President of the Federation of Pakistan Chamber of Commerce and Industry, Tanveer Ahmed Sheikh termed it a risky strategy to use liquidity provided by a change in the Cash Reserve Requirement and Statutory Liquidity requirement to maintain the stock market indicators.

COMMENT

19. (SBU) Comment. The GOP is seeking the IMF's endorsement for its economic stabilization policies -- and possibly securing hard cash from the fund itself -- which is crucial to both bilateral and multilateral lenders support. Neither the IMF endorsement of Islamabad's economic policies or its funding are likely to come unless the government, among other things, outlines a credible plan to improve the tax-to-GDP ratio, by increasing the number of sectors taxed and eliminating tax exemptions. On October 26, the GOP reversed a previous decision to increase electricity tariffs and eliminate the current subsidy by 31 percent due to widespread public protests. End Comment.

PATTERSON